

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessments of Additional)
Income Tax for the Taxable Years 1998)
and 1999 by the Secretary of Revenue)
of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2002-159

This matter was heard before the Assistant Secretary for Administrative Tax Hearings, Eugene J. Cella, in the city of Raleigh on May 6, 2002, upon an application for hearing by [Taxpayer], wherein he protested the proposed assessments of additional income tax for the taxable years 1998 and 1999. The hearing was held by the Assistant Secretary under the provisions of G.S. 105-260.1 and was attended by Taxpayer and W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division.

Pursuant to G. S. 105-241.1, assessments proposing additional tax, penalties, and accrued interest for the tax years 1998 and 1999 were mailed to Taxpayer on January 16, 2002. Taxpayer filed a timely protest to the proposed assessments and requested a hearing before the Secretary of Revenue.

ISSUE

The issue to be decided in this matter is as follows:

Are the assessments for additional income tax proposed against Taxpayer for the taxable years 1998 and 1999 lawful and proper?

EVIDENCE

The evidence presented by W. Edward Finch, Jr., Assistant Director of the Personal Taxes Division, consisted of the following:

1. Memorandum from E. Norris Tolson, Secretary of Revenue, to Eugene J. Cella, Assistant Secretary for Administrative Tax Hearings, dated May 16, 2001, a copy of which is designated as Exhibit PT-1.
2. Notice of Individual Income Tax Assessment for the taxable year 1998 dated January 16, 2002, a copy of which is designated as Exhibit PT-2.

3. Notice of Individual Income Tax Assessment for the taxable year 1999 dated January 16, 2002, a copy of which is designated as Exhibit PT-3.
4. Internal Revenue Service report of Income Tax Examination Changes for the tax years 1998 and 1999 dated October 13, 1990, a copy of which is designated as Exhibit PT-4.
5. Letter from G. D. Drum, Revenue Tax Auditor in the Central Examination Section, to Taxpayer dated November 1, 2001, a copy of which is designated as Exhibit PT-5.
6. Letter from Taxpayer to the North Carolina Department of Revenue dated February 14, 2002, a copy of which is designated as Exhibit PT-6.
7. Letter from Angela C. Quinn, Administrative Officer in the Personal Taxes Division, to Taxpayer dated March 5, 2002, a copy of which is designated as Exhibit PT-7.
8. Letter from Taxpayer to Angela C. Quinn dated April 3, 2002, a copy of which is designated as Exhibit PT-8.
9. Letter from Eugene J. Cella to Taxpayer dated April 8, 2002, a copy of which is designated as Exhibit PT-9.

At the hearing, Taxpayer presented a letter from him to Eugene J. Cella, dated April 26, 2002, a copy of which is designated as Exhibit TP-1.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. Taxpayer is and at all material times was a natural person, sui juris, and a citizen and resident of North Carolina.
2. Taxpayer did not file North Carolina or federal income tax returns for the taxable years 1998 and 1999.
3. The Department of Revenue received reports from the Internal Revenue Service indicating that the Internal Revenue Service had determined Taxpayer's federal taxable income to be \$34,640.00 for the tax year 1998 and \$42,508.00 for the tax year 1999. The amounts were determined based on a filing status of married filing separate and allowing the standard deduction and one personal exemption.
4. The Department calculated Taxpayer's North Carolina taxable income for each year by increasing Taxpayer's federal taxable income for the differences between the State and federal standard deduction and personal exemption allowances. North Carolina taxable income was determined to be \$35,890.00 for the tax year 1998 and \$43,858.00 for the tax year 1999.
5. Notices of Individual Income Tax Assessment proposing assessments of additional income tax; a twenty-five percent late filing penalty; a ten percent late payment penalty; a twenty-five percent negligence penalty; the penalty for underpayment of estimated income tax; and accrued interest for the both tax years were mailed to Taxpayer on January 16, 2002.

6. Taxpayer objected to the proposed assessments and timely requested an administrative tax hearing before the Secretary of Revenue.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. Division II of Article 4 in Chapter 105 of the North Carolina General Statutes imposes an individual income tax upon the taxable income of (1) every resident of this State and (2) every nonresident individual deriving income from North Carolina sources attributable to the ownership of any interest in real or tangible personal property in this State or deriving income from a business, trade, profession, or occupation carried on in this State.
2. A resident of North Carolina is an individual who is domiciled in this State at any time during the taxable year or who resides in this State during the taxable year for other than a temporary or transitory purpose. For residents of this State, "North Carolina taxable income" is defined as the taxpayer's taxable income as determined under the Internal Revenue Code, adjusted as statutorily provided for differences in State and federal law.
3. Federal taxable income is defined in the Internal Revenue Code as gross income less deductions and personal exemptions. Gross income is defined as all income from whatever source derived unless specifically excepted. Gross income includes compensation for services rendered and interest. Wages, salaries, commissions paid salesmen, compensation for services on the basis of a percentage of profits, tips, and bonuses are all includable in gross income. Gross income also includes amounts received as prizes and awards.
4. A taxpayer who does not claim itemized deductions may claim a standard deduction. For a married person filing separate, the basic standard deduction is \$2,500.00. The basic standard deduction is increased each year for inflation. The federal standard deduction for a married person filing separate for the tax years 1998 and 1999 is \$3,550.00 and \$3,600.00, respectively.
5. A taxpayer may claim an exemption for himself and for each qualified dependent. The basic federal exemption amount is \$2,000.00. The basic exemption amount is increased each year for inflation. The federal personal exemption for an individual entitled to only one exemption for the tax year 1998 and 1999 is \$2,700.00 and \$2,750.00, respectively.
6. Additions to federal taxable income are required for the amount by which Taxpayer's standard deduction has been increased for inflation and the amount by which each of Taxpayer's personal exemptions has been increased for inflation under the Code. Additions of \$1,250.00 and \$1,350.00 were properly made for the tax year 1998 and 1999, respectively.
7. An individual is required to file a federal income tax return if his gross income for the year equals or exceeds the allowable exemption amount. A resident of this State is required to file a North Carolina individual income tax return if the individual is required to file a federal income tax return. The North Carolina return shall show the taxable income and adjustments to federal taxable income required by statute. An income tax return shall be filed as prescribed by the Secretary. For a calendar-year taxpayer, the return is due on or before the fifteenth of April of the calendar year following the tax year.

The tax payable as shown on the return must be paid to the Secretary within the time allowed for filing the return.

8. If a taxpayer does not provide adequate and reliable information upon which to compute his tax liability, an assessment may be made upon the basis of the best information available; and, in the absence of information to the contrary, such assessment is deemed to be correct. Assessments must generally be proposed within three years of the date the return was filed or the date the return was due to be filed, whichever is the later.
9. A penalty is imposed for failure to file a return when due. The penalty is equal to five percent of the tax for each month, or fraction of a month, the return is late (minimum \$5.00, maximum twenty-five percent). Penalties of \$601.25 and \$741.25 were properly assessed for the tax years 1998 and 1999.
10. A penalty is imposed for failure to pay tax when due. The penalty is equal to ten percent of the tax (minimum \$5.00). Penalties of \$240.50 and \$296.50 were properly assessed for the tax years 1998 and 1999.
11. A twenty-five percent negligence penalty is imposed for a large individual income tax deficiency. A large income tax deficiency exists when a taxpayer understates taxable income by an amount equal to twenty-five percent or more of gross income. Penalties of \$601.25 and \$741.25 were properly assessed for the tax years 1998 and 1999.
12. An individual is required to pay estimated income tax if the tax due shown on the income tax return for the taxable year, reduced by North Carolina tax withheld and allowable tax credits is \$1000.00 or more. A penalty is imposed for any underpayment of estimated income tax. Penalties of \$124.49 and \$128.43 were properly assessed for the tax years 1998 and 1999.

DECISION

Based on the foregoing evidence of record, findings of fact, and conclusions of law, the Assistant Secretary finds the proposed assessments for the tax years 1998 and 1999 to be lawful and proper, and they are hereby affirmed. Both federal and State law impose the individual income tax on the "taxable income" of every individual. The State's definition of taxable income refers to the definition of taxable income in Internal Revenue Code section 63. Taxable income for federal purposes means gross income less allowable deductions. Gross income is defined by Code section 61 as, except as otherwise provided, all income from whatever source derived, including compensation for services.

Taxpayer has offered no defense directly addressing the calculation of the proposed liability. Rather, taxpayer claims that his income from sources within the United States is not

taxable as determined under the rules of Code Section 861(b) and the related regulations (beginning with Reg. §1861.8). Furthermore, Taxpayer claims that the income he received is excluded from taxation for federal and State purposes since the income is not on the "list" of non-exempt income found in Reg. §1861.8T(d)(2).

Section 861 is not relevant in Taxpayer's case since it is not necessary for Taxpayer to determine whether his income is from sources within or outside the United States. Regulation 1.1-1(b) provides that "in general, all citizens of the United States, wherever resident, and all resident alien individuals, are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States." In *Aiello v. Commissioner*, 69 T.C.M. (CCH) 1765 (1995), the court stated "Apparently, petitioner believes that the only sources of income for purposes of section 61 are listed in section 861, that income from sources within the United States is taxed only to nonresident aliens and foreign corporations.... Under section 61(a)(1) and (4), petitioner clearly is required to include his wages, tokens, and interest in gross income."

I find the Taxpayer's arguments to be no more than trite contentions repeatedly rejected by the courts as having no merit whatsoever. Therefore, the proposed assessments for the tax years 1998 and 1999 are hereby sustained in their entireties and are determined to be final and collectible, together with interest as allowed by law.

Made and entered this 2nd day of July, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary for Administrative Tax Hearings
North Carolina Department of Revenue